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C O N F I D E N T I A L SECTION 01 OF 02 BAKU 000337

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TAGS: PGOV PREL AJ TK RU
SUBJECT: AZERBAIJAN: A SHIFT IN GAS EXPORT STRATEGY?

REF: ANKARA 553

Classified By: Ambassador Anne E. Derse, Reasons 1.4 (b,d)

¶1. (C) SUMMARY: In the face of President Aliyev's recent high profile, energy-focused trip to Russia, SOCAR continues to insist that the goal of its gas export strategy remains export to Europe via Turkey. However, SOCAR now states that due to continued inability to find a mutually acceptable gas transit solution with Turkey, Azerbaijan's fallback position will be to export its gas to Europe through Russia, possibly via swap deals with Gazprom. Although SOCAR Is not currently considering selling any of the projected 13 to 16 billion cubic meters annually of Shah Deniz Phase Two gas to Russia when it comes on line no earlier than late 2016, it might sell some of its own (SOCAR-produced, non Shah-Deniz) gas to Russia in the shorter term. SOCAR contends that Turkey still refuses to offer it commercially viable prices for either the Shah Deniz Phase One gas it is currently receiving or the Shah Deniz Phase Two gas it is seeking to purchase. According to SOCAR, President Aliyev is not going to the Sofia Energy Summit. END SUMMARY.

2.(C) On April 21 SOCAR Marketing Vice-President Elshad Nasirov, the SOCAR official primarily responsible for gas marketing decisions, told EnergyOff that despite President Aliyev's recent press statements from Russia, Azerbaijan's gas export strategy remains the same: to export its gas to European markets. Azerbaijan's first choice as gas transit country is Turkey, but if Turkey continues to refuse to grant viable transit conditions for Caspian gas, Azerbaijan will seek to export the 13-16 billion cubic meters annually (bcm/a) of Shah Deniz Phase Two (SD2) gas scheduled to come on line no earlier than late 2016 to Europe via Russia, possibly via swap deals with Gazprom. Nasirov said that it is possible that SOCAR will sell some non-Shah Deniz gas volumes to Russia in the shorter-term, but insisted that SOCAR is not currently considering selling any SD2 gas to Russia (COMMENT: A Shah Deniz Consortium member confirmed to EnergyOff that it made 'good economic sense' for Azerbaijan to sell at least some volumes to Russia, especially if it can work out satisfactory swap arrangements such that it can sell Gazprom gas in European markets as its own).

¶3. (C) Nasirov said that discussions with Turkey over Shah Deniz gas are still moribund. Turkey is still seeking to de-link the low price it is currently paying for Shah Deniz Phase One (SD1) gas and the putatively higher price it says it would pay for SD2 gas. SOCAR opposes this de-linkage, since it is "the same gas from the same field traveling via the same pipeline over the same distance to the same market."

Nasirov flatly denied rumors that Turkey had offered USD 350 per thousand cubic meters (tcm) for SD2 gas (ref). In the formal negotiations between Botas and the Azerbaijan Gas Supply Company (AGSC - the special purpose venture led by StatoilHydro to sell SD1 gas to Turkey), Botas is still offering a three-year phased increase to USD 180/tcm, a price SOCAR feels is insultingly low. In informal discussions, Nasirov said Turkish officials have "joked" about paying 'as much as' USD 250/tcm, which SOCAR has pointed out is still way below the price Turkey pays Gazprom and Iran for gas.

¶4. (C) Nasirov denied that Azerbaijan was seeking to use gas sales to Russia as leverage for Russian help on Nagorno-Karabagh, saying that "no one in Azerbaijan is nave enough to think the Russians will give up territories for gas."

¶5. (C) Nassirov said the recent announcement of RWE Midstream gas cooperation with Turkmenistan was "an encouraging development," and added that SOCAR President Rovnaq Abdullayev would be traveling to Ashgabat shortly (Ashgabat is hosting a pipeline security conference April 23-24.).

¶6. (C) Nasirov said that President Aliyev would not be traveling to the Sofia Energy Summit, but that Energy Minister Natiq Aliyev would be attending. Nasirov said that Azerbaijan would seek to invite Turkish officials to Azerbaijan before the end of April in another attempt to break the gas deadlock. (The Turkish Ambassador had earlier told the Ambassador that Energy Minister Guler had invited SOCAR and Energy Minster Natiq Aliyev to Ankara April 28.)



¶7. (C) COMMENT: In talks with USG officials SOCAR continues to stress that the goal of Azerbaijan's gas export strategy -- to sell gas directly to Europe -- hasn't changed, and that the primary reason for its increased focus on gas cooperation with Russia is to "increase leverage on the government of Turkey" to secure transparent commercial transit terms and arrangements. But we believe there has been an important shift in the GOAJ position, at least as enunciated by Nasirov: if transit through Turkey continues to be denied, Azerbaijan will seek export routes to Europe through Russia for Shah Deniz gas, quite possibly via swap deals (Nasirov has previously told Embassy that Russia had agreed to allow its territory to be used purely for transit). The other energy companies in the Shah Deniz Consortium are all seeking primarily to find a viable customer for SD2 gas so they can monitize their investment, as the clock ticks on their Production Sharing Agreement with Azerbaijan. According to at least one SD Consortium gas executive, none of the Consortium members (with the obvious exception of TPAO) "has any problem" selling SD2 volumes to Europe through Russia, or even selling gas to Russia. Resolving the transit issue with Turkey remains essential to achieving USG goals of diversifying not just sources, but routes, of gas supply to Europe.

¶8. (C) COMMENT (CONT): As for a putative signing of the Nabucco IGA in early May in Prague, conversations with SOCAR and other SD Consortium members indicate their view that while any IGA incorporating commercially viable and 'clean' transit principles through Turkey (i.e. without linking gas transit through Turkey to gas sales to Turkey) would be seen as welcome recognition of market realities, SOCAR and the Shah Deniz Consortium's optimal solution is one where Turkey allows provides a transparent and commercially viable transit regime for any/all upstream gas, irresepective of pipeline project or final consumer. This way, SOCAR and the SD Consortium could calculate netbacks for various pipeline projects vying for SD2 gas in order to decide which pipeline project (Nabucco, TGI, TAP) to support with its SD2 volumes. As such, SOCAR requests to the USG and EU have been to not champion specific pipeline projects, but rather to bring about viable transit through Turkey so that commercial

factors can then determine which pipeline(s) get sanctioned.
END COMMENT.
DERSE